

SWIDLER BERLIN SHEREFF FRIEDMAN, LLP

THE WASHINGTON HARBOUR
3000 K STREET, NW, SUITE 300
WASHINGTON, DC 20007-5116
TELEPHONE (202) 424-7500
FACSIMILE (202) 424-7645
WWW.SWIDLAW.COM

NEW YORK OFFICE
THE CHRYSLER BUILDING
405 LEXINGTON AVENUE
NEW YORK, NY 10174
TEL (212) 973-0111
FAX (212) 891-9598

PATRICK J. DONOVAN
DIRECT DIAL: (202) 424-7857
FAX: (202) 424-7643
PJDONOVAN@SWIDLAW.COM

December 19, 2002

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Ex Parte

WC Docket Nos. 96-98, 98-147, 01-338

Dear Ms. Dortch:

Pursuant to Section 1.1206 of the Commission's rules, 47 C.F.R. § 1.1206, this will provide notice that on December 18, 2002, Jerry Finefrock, Vice President-Regulatory Affairs, LDMI Telecommunications, and the undersigned met with: (1) Christopher Libertelli, Office of the Chairman; and (2) Rob Tanner and Daniel Shiman, Wireline Competition Bureau concerning issues in the above-captioned proceedings. We presented the views set forth in the attached documents which were provided at the meetings.

Sincerely,



Patrick J. Donovan
Counsel for
LDMI Telecommunications, Inc.

SBC on UNE-P and TELRIC:

Claims Must Be Compared To Their Track Record

Jerry Finefrock

LDMI Telecommunications, Inc. (Michigan)

248-840-2896 jfinefrock@ldmi.com

12/18/02

The SBC Claim:

- **SBC PROFITS ARE FALLING:** Because of “below-cost... UNE-P” and wholesale prices which are “nuts”[1], SBC’s profits are “falling like a rock”.[2]

[1] Crain’s Detroit Business 9/2/02, quoting Ed Whitacre of SBC.

[2] The Digest, 8/29/02, quoting SBC President Ed Whitacre’s statement to the Detroit Free Press.

The Facts:

- For calendar year 2001, SBC was listed by Fortune as one of the thirty largest Fortune 500 companies.
 - For the “Fortune 30”, year 2001, SBC had a profit margin (net income after tax, vs.revenues) of 15.8%, or **more than three times** the 4.6% recorded by the rest of the Fortune 30.
- And lest you believe SBC that things got worse in 2002:
 - For first quarter 2002, SBC’s results actually **improved**, to 16.3% (vs. 6.1% for the other Fortune 30).
 - Second quarter 2002, SBC improved **again**, to 16.8%, or eight times the 2.3% recorded by the rest.
 - Third quarter 2003, SBC held at 16.8%, versus 6.1%; year to date 2002: SBC, 16.7% profit margin, versus 4.7% for the rest of the Fortune 30: **SBC three times the profit margin of the rest.**[1]

[1] Fortune 500 data, Fortune, 2001. 2002 data compiled from MarketGuide/Provestor Plus Company Reports from multex.com.

The Facts on SBC Profits (cont.)

- SBC ***also*** is currently performing exceedingly well as compared to the ***rest*** of the ***telecommunications*** industry. Recent results:
 - Return on Assets – SBC 6.9%; Industry 0.9%
 - Return on Investment – SBC 9.0%; Industry 1.5%
 - Return on Equity – SBC 20.5%, Industry 4.0%
 - Operating Margin – SBC 20.6%, Industry 12.6%
 - Profit Margin – SBC 15.0%, Industry 1.7%.[1]

[1] MarketGuide/Provestor Plus Company Report, SBC Communications Inc., December 15, 2002.

The Facts on SBC's Profits (cont.)

- And according to SBC's chief financial officer, Randall Stephenson,
 - “our balance sheet is second to none right now...
 - “we are going to throw off just in excess of 3 billion dollars of free cash flow after dividends this year.
 - “The result of all that is I would tell you ***we're the best capitalized telecom business in the world...***
 - “when you compare us to our peers in this industry from just a pure financial position, we are ***second to none....***
 - “our ***free cash flow*** before dividends this year ***will nearly double what we achieved last year.***”^[1]

^[1] Randall Stephenson, SBC CFO, Bank of America Securities Annual Investment Conference, Sept. 23-26, 2002.

The 2nd SBC Claim:

- **SBC PROFIT PROBLEM IS WORST IN AMERITECH REGION, PARTICULARLY MICHIGAN.**[1] “SBC, the Texas company that acquired Ameritech, maintains that its *Michigan operations lost more than \$1 billion during the last three quarters.*”[2]

[1] Detroit Free Press 8/31/02; Chicago Tribune, 9/4/02; TR's State Newswire, 8/30/02; SBC's William Daley, letter to editor of Cleveland Plain Dealer, 9/17/02.

- [2] Detroit News Editorial, October 3, 2002.

The Michigan Facts:

- According to SBC figures filed in the FCC's ARMIS database, for calendar year 2001, Ameritech Michigan's profit margin was 18.5%[1], or six times the 2.8% recorded by the Fortune 500.
- Had Ameritech Michigan been listed as a member of the Fortune 500 for calendar year 2001, its after-tax net income would have ranked it ahead of 375 of the 500 companies on the Fortune 500: ahead of Dow Chemical and even General Motors.

[1] ARMIS, 43-02, acct 178, net income; acct 48, total operating revenue.

Michigan Facts (cont.)

- The 2001 profit margin of Ameritech Michigan, per ARMIS, was higher than that of ***any other SBC company***.
- Also in 2001 per ARMIS, Ameritech Michigan's after-tax profit per phone line was over \$81^[1], higher than any other Bell company in the U.S., and **2 1/2** times that of ***Verizon***.

-

[1] ARMIS 43-08, total access lines; and data elements shown, previous slides.

(Source: ARMIS)	
2001 Results:	After-Tax Profit Margin
Ameritech Michigan	18.5% *
Ameritech Ohio	17.3%
Ameritech Indiana	16.8%
Ameritech Wisconsin	16.8%
Ameritech Illinois	15.7%
SNET	10.0%
Southwestern Bell	9.1%
Pacific Bell	8.3%
Nevada Bell	-1.0%
Total - SBC	11.5%

* "SBC executives reserve special scorn for Michigan..."
(Wall Street Journal, 12/12/02)

While SBC
Claims That
It's Profits Have
Been Hurt In
Michigan and
Ameritech By
UNE-P, The
FACTS Show
Ameritech
Michigan Profits
Are **TWICE** As
High As In
Whitacre's
SWBT!

Michigan Facts (cont.)

- Nor were the 2001 results for Ameritech Michigan an anomaly.
- In 1996, Ameritech Michigan had after-tax net income of \$458, and this figure then grew by 40 percent to reach the 2001 number of \$640 million
- – nearly two-thirds of a billion dollars, from a state that represents only about 3 1/2 percent of the U.S. population.

The 3rd SBC Claim:

- **THE REQUIRED PRICE FOR UNE-P IN MICHIGAN:** At the end of August 2002, SBC demanded the Michigan Public Service Commission permit it to hike its Michigan UNE-P price to “**\$34, which it says is the cost**”.[1]

[1] Amy Lane, Crains Detroit Business, 9/17/02.

The Facts:

- On November 18, 2002, SBC submitted into the FCC's record its plan for the "Development of a Sustainable Wholesale Model", where UNE-P-like service would be provided to CLECs at a price of \$26.
- If, as SBC testified in Michigan, its **cost** is **\$34**, and it is precluded by Michigan law in selling service below cost, how can it then offer service for **\$26**?

And Then More Facts:

- Meanwhile, SBC' CFO Randall Stephenson says that at \$20 to \$21, the UNE-P price is pretty good: "So state of Texas, it's about a \$20/21 UNEP. You know, the state of Texas, you have a pretty rational model. You know at \$20/21, you have good, vibrant competition and it's not at such a level where we cannot earn money or are disincented to invest."[1]

[1] Randall Stephenson, CFO of SBC, Speaking at Bank of America Securities Annual Investment Conference, Sept. 23-26, 2002.

SBC Cannot Be Trusted

- Claims \$34 is actual UNE-P cost
- Then tells FCC \$26 is an o.k. price
- Then quietly tells investment community that \$20 or \$21 is an o.k. price
- And at \$20 or \$21, it can earn money and still has an incentive to invest

Conclusion:

- The assumption that “Something has to be done about UNE-P” and that “Something has to be done about TELRIC” was based on the assumption that SBC was telling the truth about alleged UNE-P losses, and its UNE-P financial problems in Ameritech.
- But these statements, from the beginning, were ***false***.

SBC Misrepresents Michigan Service Quality

- 2/8/2002 SBC press release: “SBC Ameritech Michigan Dramatically Improves Service Quality in 2001”.
- The 2001 Facts (FCC ARMIS):
 - SBC Michigan “initial out-of-service repair interval” worst in U.S.: SBC Michigan 36.1 hours; BellSouth 19.2; Qwest 14.1; SWBT 23.6; Verizon 21.2.
 - State complaints per million lines: SBC Michigan 425; BellSouth 232; Qwest 228; SBC 181; Verizon 185.
 - Customer satisfaction survey: SBC Michigan also the worst: residence; also worst, business.

SBC Misrepresents Michigan Investment

- 1/9/02 SBC press release: “SBC Ameritech contributes nearly \$3 billion to Michigan economy during 2001... more than \$1 billion in taxes paid and employee payroll”.
- The actual facts (FCC ARMIS, 2001 data):
 - After depreciation and amortization, SBC Michigan’s total operating expenses were only \$1.4 billion. So how did they contribute \$3 billion to Michigan economy?
 - Total compensation was \$693 million; taxes \$123 million. Claim of “more than \$1 billion” is false.

SBC Misrepresents # of Michigan CLECs

- “As of September [2002], there are 75 different CLECs operating in our service territory in Michigan” (SBC Michigan PSC testimony, 11/25/02).
- MPSC: The top 15 CLECs in Michigan represent 96% of the CLEC lines (CLECs think there are only about 20 CLECs now operating in Michigan)

(Mich PSC, Competitive Market Conditions Update, Oct. 2002)

SBC Misrepresents the Competitive Reach of Facilities-Based CLECs in Michigan

- SBC: Michigan facilities-based CLECs “have the capability today to address... 82 percent of our business customers and 76 percent of our residential customers”.

(SBC Michigan PSC testimony, 11/25/02.)

- Wrong. SBC admits that “CLECs are collocated in approximately 125 SBC Ameritech wire centers in the state of Michigan, or about a ***third*** of all wire centers”. (SBC Michigan data, 11/25/02.) And CLECs say the real number of collocations capable of ***local dial tone*** is about 65, or a ***sixth*** of all wire centers. (CLEC Michigan PSC testimony, 11/25/02)

Misrepresentation: SBC Claims Huge Michigan Local Rate Cut

- **The Claim:** SBC press release, 6/11/02: "SBC Ameritech Announces \$26 Million Savings for Michigan Customers. Majority of Michigan Customers Will Be Converted to Unlimited Local Service; Prices Reduced by Up to 30 Percent..."
- SBC Ameritech announced today that it will be making sweeping changes to its existing residential customer call packages, converting more than 75 percent of its residential customers to unlimited local service and dramatically lowering rates for other customers on the unlimited local plan. In addition, the company will offer unlimited local toll for the first time in its history, adding the service to more than 100,000 customers' packages with no change in price.
- More than 2.2 million SBC Ameritech customers will benefit...resulting in prices reduced by up to 30 percent and a total of more than \$26 million in savings annually.. SBC has slashed the price of its stand-alone unlimited local calling offer from \$21 to about \$14. We are contacting our 2.2 million customers to tell them that these benefits are being added to their packages," said Gail Torreano, president, SBC Ameritech Michigan. "Personally, I plan to knock on doors in Southeast Michigan neighborhoods with our employees to tell customers about the changes and listen to the feedback they have for us."
- **The Facts:** The \$26 million rate cut was accompanied by request to hike directory assistance rates – canceling out the savings. But even taken at face value, \$26 million represents only **eight-tenths of one percent** of SBC's annual revenues in Michigan: \$3.465 billion (ARMIS).
- Only 4 percent of SBC's Michigan customers received the \$21-to-\$14 rate cut. The vast majority of SBC's customers didn't make more than 400 local calls per month, and thus received no savings whatsoever in being converted to flat-rate service.

Actual Situation on SBC Michigan Local Phone Prices:

- SBC Michigan's local phone prices over last 10 years have increased more than other RBOCs: SBC Michigan: 38%; Qwest 25%; Verizon, 7%

reduction (ARMIS 43-03 table I, account 5000, local services revenue; 43-08, table II, total switched access lines.)

- FCC "sample cities" data, last 10 years: Michigan cities, 41.7% increase; rest of U.S., 6.1% increase. (Table 1.4, Reference Book of Rates, Price Indices.. for Telephone Service, Industry Analysis and Technology Division, FCC, July, 2002: weighted by population data from U.S. Census for each city, 2000 census data; SBC Ameritech Michigan compared to rest of U.S. outside of Ameritech region. For the remainder of Ameritech states, the increase over the 10-year period was 11.3%.)

SBC Misrepresents Its Michigan Long-Distance Rates

- “Every day of delay [in 271 approval] is another day **Michigan** consumers pay more for **long distance** service than they should,” said Gail **Torreano**, president, **SBC Ameritech Michigan**. (www.lightreading.com, 7/30/02).
- In 2001, SBC Michigan had toll revenues of \$459 million—larger than BellSouth’s, for all 9 states combined; larger than SWBT, for all 5 states; almost twice that of Qwest, all 14 states combined (ARMIS).
- In 2001, Qwest had average toll revenue per line of \$15.48. SBC Michigan: \$95.51/line – highest of any RBOC in the country. (ARMIS: long distance revenues divided by switched access lines)

Overall Conclusion

- SBC's claims during the last year – in Michigan, to the FCC, and to the public – have been universally false.
- FCC must respond to Court of Appeals on UNE-P (etc.), but should give no weight to SBC claims.
- FCC may want to revisit TELRIC, but should give no weight to SBC claims that TELRIC pricing is below cost.

A Transition Plan For UNE-P:

Meeting the Court's Tests While Preserving Competition

Jerry Finefrock

LDMI Telecommunications, Inc. (Michigan)

248-840-2896 jfinefrock@ldmi.com

12/18/02

About LDMI

- LDMI: largest telecom company headquartered in Michigan: \$100 million annual revenues.
- A facilities-based long distance carrier, since its inception 10 years ago. Now profitable.
- Over next 2 years, plans 3 CLEC switches, and 40+ colocations.

Choosing A Transition Plan

- LDML supports the ASCENT UNE-P transition plan [ex parte, 12/4/02], (market-based test where “market” equals a **wire center**).
- The Talk America/Broadview/Eschelon transition plan (CLEC-based test, again based on lines in a given **wire center**) also has merit.

Rejecting Unreasonable Views

- FCC is right to look askance at CLECs who have local switches and colos, and choose not to use them.
- Views that say “UNE-P must remain, everywhere and forever” may not meet the court test.
- But RBOC statements about UNE-P are outrageous, untrue and must be rejected.

The Hot-Cut Problem

- FCC accepts there is a hot-cut problem, and it must be solved.
- But it must be solved first: the transition away from UNE-P cannot begin until the hot-cut problem has been solved, else RBOCs will never solve it.
- If there is a solution to hot-cut problem that doesn't involve electronic and automatic processing, we don't know what it is.

Other Strange And Unusual Last-Minute “Alternatives” Must Be Rejected

- DS0 EELs will not work. Those few carriers with DS0 EELs experience note it failed miserably. It has its own host of manual hot-cut problems. Its economics appear totally unfavorable. The RBOCs can and will foul it up.
- DS0 EELs cannot in any way be considered a substitute for UNE-P.

FCC Must Preserve Business UNE-P Service During The Transition, Equal to Protection of Residence UNE-P Service

- AT&T and WorldCom may not care about business UNE-P, but dozens of other CLECs ***and their business customers*** do.
- There are 300,000 business establishments in Michigan, and 30,000 of those are LDMI customers.
- LDMI has UNE-P business customers in every Ameritech wire center in Michigan, including the furthest rural portions of the Upper Peninsula.

Preserving Business UNE-P (cont.)

- There are now an estimated 8.78 million UNE-P lines (Pace Coalition, 11/13/02), and we estimate that 1.4 million of those lines are business UNE-P lines.
- At an average of 5 lines per business customer (LDMI business UNE-P average, which we believe is representative), we estimate 280,000 U.S. businesses are now served by UNE-P.

Preserving Business UNE-P (cont.)

- For those 280,000 U.S. businesses, UNE-P represents their first chance **ever** to save money or have an alternative, for their local phone service.
- These are small businesses, which numerous studies have indicated are the key driver for our economy, and the key engine providing new jobs in America.

Preserving Business UNE-P (cont.)

- For those 280,000 U.S. businesses, if the FCC takes UNE-P away, where will they go?
- For the great majority, they will be forced to return to the RBOC they were trying to escape: facilities-based competition does not exist in about 75% of U.S. wire centers today, and won't, for years to come.

Preserving Business UNE-P (cont.)

- For small businesses with less than 50 phone lines, the impairment is the same as for residential phone customers.
- Large businesses with digital PBXs can prove in T1 (DS1) interfaces, connecting to a CLEC switch.
- But below 50 lines, small businesses have key systems, often analog, that cannot enjoy such opportunities.
- Facilities-based CLECs are typically selling to businesses who transmit digitally (T1 and above): and that's businesses with more than 50 phones.

Preserving Business UNE-P (cont.)

- There is a misconception that since many key systems (serving 50-line or less businesses) now operate digitally, that means the business can connect to the CLEC digitally.
- Most RBOCs have continued historic policies where they charge extra to connect business lines to the customer on digital, rather than analog facilities. So the key systems continue to be designed and engineered with analog interfaces.

Preserving Business UNE-P (cont.)

- Small businesses also tend to be tied-up by long-term RBOC contracts, that represent a further impairment.
- Although well-meaning, the FCC's existing 4-line restriction on UNE-P, and "densest part of MSA" restriction is an unwarranted barrier to many small businesses who are impaired; as UNE-P transition plan that meets the court test is implemented, that restriction should be removed.

The Test Regarding UNE-P Elimination Must Be At *Wire Center* Level

- It does no good to declare the Los Angeles “market” to be competitive, if customers in many of the wire centers in that market do not have competitive CLEC opportunities.
- The competitive test must be done on a wire-center by wire-center basis – and the state commissions are best equipped to make that granular determination.

CLECs Need Time To Build Facilities

- Initial migration: 18 months
- Subsequent migrations: at least 6 months

CLECs Must Be Able to Continue to Acquire Customers via UNE-P

- In existing collocations to achieve sufficient numbers of lines for migration
- To acquire customers in non-collated locations to build toward density triggers
- To acquire and serve customers who have both on-net and off-net locations

Meeting FCC's Concerns

- Both the ASCENT and Talk America/Broadview plans answer the need:
 - Enabling CLECs to reach critical mass, but requiring them to migrate to facilities-based CLEC operation when they succeed.

Meeting DC Circuit Tests

- For both ASCENT and Talk America/Broadview, impairment is tied to ILEC hot cut inadequacy and network/interconnection costs imposed on CLEC by ILEC
- ASCENT vs. Talk America/Broadview:
 - ASCENT requires 5 independent wholesale carriers at the wire center level for migration
 - Talk America/Broadview has a line density requirement at LATA level, and a line density requirement at the wire center level

Under Either Migration Plan:

- ILECs need to remove hot cut impairment
- CLECs must deploy facilities
- FCC needs to set national guidelines
- States must implement migration rules

Result: Rational, economic investment in facilities-based competition for all consumers.

LDMI's Network Economics

- LDMI's gross margins on both facilities-based long distance, and UNE-P based local service, are about 50%.
- Sales & customer service costs: 20% of revenue. General & administrative costs (G&A), 20% of revenue. Net margin: 10% of revenue.
- $50\% + 20\% + 20\% + 10\% = 100\%$ revenue.
- Only a portion of net revenue flows to profit: after tax profit is well below 10%.

Network Economics (cont.)

- RBOCs would have you believe that a lower gross margin on UNE-P is “acceptable” – such as 20%.
- Result:
 - 80% cost for UNE-P
 - 20% cost for sales & customer service
 - 20% cost for G&A
- CLEC can't **make** money: they are guaranteed to **lose 20%** on every dollar of sales!

Conclusions

- FCC should adopt either the ASCENT or Talk America/Broadview UNE-P transition plan.
- Every state commission has told you the Bells are wrong when they say TELRIC is priced below cost – extensive hearings and testimony, etc.
- No evidence supports SBC/RBOC claims about losses or other dire predictions. FCC should support a system that has been proven to work, and implement a transition plan that meets the test of the courts.